Rules and Regulations

Federal Register
Vol. 63, No. 24
Thursday, February 5, 1998

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 791

Rules of NCUA Board Procedure; Promulgation of NCUA Rules and Regulations; Public Observation of NCUA Board Meetings

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: The NCUA Board amends its rules to revise and clarify Board procedures relating to the scheduling and subject matter of Board meetings. This amendment more clearly describes the content of the written submissions that are required when Board members want to call a special meeting or when a Board member wants to place items on a regular meeting agenda.

DATES: Effective on February 5, 1998.

ADDRESSES: National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314–3428.

FOR FURTHER INFORMATION CONTACT: Robert M. Fenner, General Counsel, Office of the General Counsel, at the above address or telephone (703) 518–6540. E-mail questions may be sent to ogcmail@ncua.gov.

SUPPLEMENTARY INFORMATION: Part 791 of NCUA Rules and Regulations, 12 CFR Part 791, governs the manner in which the Board conducts NCUA business, including the scheduling and subject matter of Board meetings. These amendments clarify the NCUA Board's intention when it amended §§ 791.5(a)(2) and 791.6(a). 62 FR 64266, December 5, 1997.

Section 791.5(a)(2) is amended to specify that a request for a special meeting from two Board members must be made by submitting an NCUA B–1 form and Board Action Memorandum stating the specific issue(s) or action(s) to be considered by the Board.

A parallel amendment is being made to § 791.6(a). The NCUA B–1 form and the Board Action Memorandum that a Board member uses to submit an item for the agenda of the next regularly scheduled meeting must state the specific issue(s) or action(s) to be considered.

Immediate Effective Date

Because these amendments concern the rules of NCUA Board procedure, prior notice and comment are not required by 5 U.S.C. 553. These amendments are effective February 5, 1998.

Regulatory Procedures

Regulatory Flexibility Act

NCUA certifies that these amendments to part 791 will not have a significant impact on a substantial number of small credit unions. Accordingly, a regulatory flexibility analysis is not required. The rule affects internal NCUA Board operations only. Thus, it will not result in any additional burden for regulated institutions.

Paperwork Reduction Act

The amendments to the rule do not contain any collection of information requirements pursuant to the Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget.

Executive Order 12612

Part 791 only applies to NCUA and the NCUA Board. Accordingly, NCUA has determined that the rule will not have a substantial impact on the states or state interests. Further, the rule will not preempt provisions of state law or regulations.

List of Subjects in 12 CFR Part 791

Administrative practice and procedure, Sunshine Act.

By the National Credit Union Administration Board on January 22, 1998.

Becky Baker,

Secretary to the Board.

Accordingly, NCUA amends 12 CFR part 791 as follows:

PART 791—-RULES OF NCUA BOARD PROCEDURE; PROMULGATION OF NCUA RULES AND REGULATIONS; PUBLIC OBSERVATION OF NCUA BOARD MEETINGS

1. The authority citation for part 791 continues to read as follows:

Authority: 12 U.S.C. 1766, 1789 and 5 U.S.C. 552b.

2. Section 791.5 is amended by revising paragraph (a)(2) to read as follows:

§ 791.5 Scheduling of board meetings.

(a) * * *

(2) *Special meetings.* The Chairman shall call special meetings either on the Chairman's own initiative or within fourteen days of a request from two Board members that is accompanied by an NCUA B–1 form and a Board Action Memorandum that states the specific issue(s) or action(s) to be considered by the Board.

* * * * *

3. Section 791.6 is amended by revising the last sentence in paragraph (a) to read as follows:

§ 791.6 Subject matter of a meeting.

(a) *Agenda.* * * * Items shall be placed on the agenda by determination of the Chairman or, at the request of any Board Member, an item will be placed on the agenda of the next regularly scheduled meeting provided that the request is submitted at least ten days in advance of the next regularly scheduled meeting and is accompanied by an NCUA B–1 form and a Board Action Memorandum that states the specific issue(s) or action(s) to be considered by the Board.

* * * * *

[FR Doc. 98–2770 Filed 2–4–98; 8:45 am]
BILLING CODE 7535–01–U

SMALL BUSINESS ADMINISTRATION

13 CFR Part 107

Small Business Investment Companies

AGENCY: Small Business Administration.

ACTION: Final rule.

SUMMARY: The Small Business Programs Improvement Act of 1996 made a number of changes to the Small Business Investment Act of 1958, as amended. For the Small Business

Investment Company program, these changes include provisions affecting capital requirements, Leverage eligibility and fees, and the status of Section 301(d) Licensees. This final rule implements the statutory provisions; in addition, it makes various technical corrections and clarifications, as well as other changes to provide greater fairness and flexibility in such areas as portfolio diversification requirements, Cost of Money and distributions by SBICs that have issued Participating Securities.

DATES: This final rule is effective February 5, 1998.

FOR FURTHER INFORMATION CONTACT: Leonard W. Fagan, Investment Division, at (202) 205–7583.

SUPPLEMENTARY INFORMATION: On October 14, 1997, SBA published a proposed rule to implement the provisions of Title II of Public Law 104–208 (September 30, 1996), entitled ''The Small Business Programs Improvement Act of 1996,'' which relate to small business investment companies (SBICs). See 62 FR 53253. The proposed rule also included certain other substantive changes, clarifications and technical corrections to the regulations governing SBICs, including those concerning portfolio diversification, Cost of Money, and the computation of distributions to be made by SBICs that have issued Participating Securities.

SBA received 10 comment letters on the proposed rule during the 30-day public comment period. This final rule includes changes based on some of the comments received. In addition, the final rule incorporates certain provisions of Public Law 105–135, which was enacted December 2, 1997.

Section 301(d) Licensees

Prior to October 1, 1996, an SBIC program applicant could be licensed under either section 301(c) or section 301(d) of the Small Business Investment Act of 1958, as amended (Act). A Section 301(d) Licensee, also known as a ''specialized SBIC'' or ''SSBIC'', agreed to invest only in businesses owned and controlled by socially or economically disadvantaged individuals. In return, a Section 301(d) Licensee received certain benefits not available to other SBICs, such as eligibility for certain types of subsidized Leverage (as defined in § 107.50).

Effective October 1, 1996, section 208(b)(3) of Public Law 104–208 repealed section 301(d) of the Act. However, the repeal provision was accompanied by the following language: ''The repeal * * * shall not be construed to require the Administrator to cancel, revoke, withdraw, or modify any license issued under section 301(d) of the Small Business Investment Act of 1958 before the date of enactment of this Act.''

At the same time, section 208(d) of Public Law 104–208 amended the Act to eliminate subsidized SBA Leverage. Such Leverage was previously available to SSBICs in the form of Debentures with an interest rate subsidy or Preferred Securities with a 4 percent dividend. Although subsidized Leverage can no longer be issued, the Act does not require SSBICs to prepay or redeem such Leverage prior to its scheduled maturity. In addition, an SSBIC may apply for any type of non-subsidized Leverage (Debentures or Participating Securities) for which it is eligible.

To implement these statutory changes, SBA proposed revisions to the definitions of ''Section 301(d) Licensee'' and ''Preferred Securities'' found in § 107.50, as well as to §§ 107.120, 107.230(d)(4), 107.1100, 107.1160, 107.1400, 107.1420 and 107.1430; §§ 107.110 and 107.1110 were proposed to be removed. These sections are finalized with one modification, as discussed hereafter.

SBA received one comment concerning proposed § 107.120. The proposed rule would have allowed an existing SSBIC which was licensed as a subsidiary of another Licensee or group of Licensees to continue its operations under the same conditions as before; however, an existing SSBIC that was not already a subsidiary would not have been permitted to become one. The commenter suggested that Section 301(d) Licensees should continue to have access to this option. Although the current provision has rarely been used, SBA has no objection to its continued availability and has revised the final rule accordingly.

Common Control

SBA proposed to broaden a portion of the defined term ''Common Control'' in § 107.50. The purpose of the change was to reflect the way the term is actually used in the regulations. The definition is adopted as proposed.

Management and Ownership Diversity

Proposed § 107.150 is adopted without change. SBA received one comment on this section expressing support for the general requirement that a Licensee which plans to obtain SBA Leverage must have diversity between management and ownership. Under the revised regulation, the investors relied upon to satisfy the diversity requirement cannot be Affiliates of one another. In addition, SBA has discretion to reject for diversity purposes an investor whose ownership interest is not significant, either in terms of absolute dollars or percentage of ownership.

These changes reflect policies which SBA has been developing in its review of license applications. SBA is continuing to refine these guidelines and expects to incorporate them into its standard operating procedures.

Capital Requirements

Under the Act as amended by section 208(c) of Public Law 104–208, SBICs licensed on or after October 1, 1996 must meet increased minimum capital requirements. These requirements are implemented in § 107.210, which is finalized as proposed. Under this section, a company that does not wish to be eligible to issue Participating Securities must have Regulatory Capital of at least $5,000,000. As an exception to this general rule, the regulation provides that SBA can license an applicant with Regulatory Capital of at least $3,000,000, but only if the applicant meets certain conditions. As mandated by the Act, this exception is limited to those instances where ''special circumstances and good cause'' can be shown.

A company that wishes to be eligible to apply for Participating Securities must have Regulatory Capital of at least $10,000,000, with a permitted exception for an applicant which demonstrates to SBA's satisfaction that it can be financially viable over the long term with a lower amount (but under no circumstances less than $5,000,000). The regulation does not permit prospective Participating Securities issuers to be licensed pursuant to the exception available to other applicants, under which a license may be granted with Regulatory Capital as low as $3,000,000. For applicants planning to issue Participating Securities, SBA believes that the ability to meet the standard minimum capital requirement is an important indicator of the credibility of management. SBA also doubts that any such applicant can demonstrate financial viability with Regulatory Capital of only $3,000,000, even on a temporary basis.

In addition to the Regulatory Capital requirements described above, § 107.210(a) also requires any company licensed on or after October 1, 1996, to have Leverageable Capital of at least $2,500,000. Leverageable Capital is a subset of Regulatory Capital; while both include capital actually contributed to a Licensee by its private investors, the major difference between them is that Regulatory Capital also includes the Licensee's unfunded binding

commitments from Institutional Investors.

SBICs licensed before October 1, 1996, are not required to increase their capital. Under § 107.210(b), such companies must continue to meet the applicable minimum capital requirements under the regulations in effect on September 30, 1996 (see §§ 107.210 and 107.220 as in effect on that date). These requirements vary depending upon the date a company was licensed and the type of SBA Leverage it has issued or wants to issue.

See also the section of this preamble entitled ''Eligibility for Leverage and Leverage Commitments''.

Valuations

Section 208(f)(2) of Public Law 104–208 included one provision related to the valuation of portfolio securities held by Licensees which was not already reflected in the regulations. Under this provision, as part of the annual audit of a Licensee's financial statements, the independent auditor must provide to SBA a statement that the Licensee's valuations were performed in accordance with its SBA-approved valuation policy, as required by section 310(d)(2) of the Act. SBA included this requirement in proposed § 107.503(e), which is finalized without change.

Reports To Be Filed With SBA

SBA received one comment on proposed § 107.660(d), which would have required a Licensee to notify SBA if an officer, director, general partner or other Control Person is charged with or convicted of any criminal offense other than a misdemeanor involving a minor motor vehicle violation. The purpose of the proposed rule was to give SBA a mechanism for updating information typically provided at the time of licensing by key personnel associated with a license applicant. The commenter pointed out that the broad regulatory definition of ''Control Person'' may cause the notification requirement to apply to persons who were not required to provide personal history statements to SBA as part of the licensing process and who have no direct role in the management of the SBIC.

SBA agrees that the proposed regulation may, under certain circumstances, unnecessarily include persons who are not involved in the operations of a Licensee. The final rule is modified accordingly, so that the notification requirement applies to any officer, director or general partner of a Licensee, and any other person who was required to provide a personal history statement to SBA in connection with the SBIC's license (either at the time of licensing or subsequently, as in the case of a new investor who acquires a significant interest in an existing SBIC).

Financing of Smaller Enterprises

Proposed § 107.710 is adopted without change. This section includes a provision applicable to SBICs licensed on or before September 30, 1996, which issue Leverage after that date and which do not meet the current minimum capital requirement (Regulatory Capital of at least $5,000,000 for Debentures or at least $10,000,000 for Participating Securities). For such Licensees, at least 50 percent of the aggregate dollar amount of their Financings extended after September 30, 1996 must be invested in Smaller Enterprises.

Under § 107.710(e), a Licensee which has not achieved the required percentage of investments in Smaller Enterprises is allowed one additional year to bring its portfolio into compliance. However, such a Licensee is not eligible for additional Leverage until it reaches the required percentage. See also the section of this preamble entitled ''Eligibility for Leverage and Leverage Commitments''.

Passive Businesses

SBA received five comments on proposed § 107.720(b), which dealt with the financing of passive businesses. SBICs are generally prohibited from investing in passive businesses, but an exception is provided for holding companies which pass through substantially all of the financing proceeds to an active subsidiary. The proposed rule would have modified the existing exception by allowing a holding company to pass through proceeds to more than one operating company, rather than a single company, provided that each operating company qualified as a ''subsidiary'' of the holding company. A subsidiary company was defined as one in which the financed passive business owns at least 50 percent of the voting securities.

All of the commenters supported the provision allowing proceeds to be passed through a holding company to more than one operating company. However, four of the commenters were concerned that the proposed 50 percent ownership requirement would foreclose another type of investment structure which may be important to certain Licensees organized as limited partnerships. Specifically, for a partnership with tax exempt investors (such as pension funds), direct investment in an unincorporated business is considered highly undesirable because of the possibility that the tax exempt investors will be deemed to have ''unrelated business taxable income'' under section 511 of the Internal Revenue Code of 1986, as amended. The common solution to this problem is for the partnership to form a wholly-owned corporate subsidiary which receives funds from its parent and in turn reinvests these funds in one or more unincorporated operating companies. If an SBIC creates a passive corporation for this purpose, it is likely that the corporation would own less than 50 percent of the voting securities of the financed Small Business. Therefore, the investment would not qualify for the exception in proposed § 107.720(b)(2).

SBA does not wish to prevent partnership Licensees from investing in unincorporated Small Businesses, but it has a number of concerns. First, SBA believes that when a Licensee makes an investment in a holding company which is unrelated to the Licensee and is, in fact, a portfolio company, the requirement that proceeds be passed through only to 50 percent-owned subsidiaries should remain. This provision ensures that there is a significant relationship between the financed passive business and the active businesses which ultimately receive the proceeds, and that the passive business is not functioning simply as a reinvestor.

Second, SBA believes that there may be significant credit risks associated with the formation of corporate subsidiaries by SBICs. For example, Licensees are prohibited by law from filing for bankruptcy protection, providing SBA with an important safeguard in its effort to manage the government's financial risk. However, when a Licensee holds assets through a subsidiary, the possibility arises that these assets can be shielded through a bankruptcy filing by the subsidiary.

To accommodate the Agency's concerns as well as those of certain Licensees, SBA is finalizing § 107.720 as follows: The exception in proposed § 107.720(b)(2) is adopted without change, and a further exception is added in a new paragraph (b)(3). Under this new provision, a partnership Licensee may form one or more wholly-owned corporations with SBA's prior written approval. Such corporations must be formed for the sole purpose of providing Financing to one or more eligible, unincorporated Small Businesses. The formation of such corporations is limited to situations in which a direct investment in the Small Business would cause one or more of the Licensee's investors to have unrelated business taxable income. The regulation resolves

potential contradictions within part 107 by specifying that ownership of such a corporation does not violate the limitations on Control in § 107.865(a) or the conflict of interest prohibitions in § 107.730(a).

SBA wishes to emphasize that the requirement for prior written approval to form a subsidiary is consistent with longstanding practice within the SBIC program. SBA's concern in this regard relates not only to credit risks associated with the shift of assets from a Licensee to its subsidiaries, but also to the purpose for which a subsidiary is formed and whether its proposed function is consistent with the purpose of an SBIC as set forth in the Act.

Co-Investment With Associates

SBA received two comments in support of proposed § 107.730(d)(3)(iv), which is finalized without change. Under this provision, co-investments by a non-leveraged SBIC and its non-SBIC Associate are presumed to be fair and equitable to the SBIC, so that no specific demonstration of equity is required.

Portfolio Diversification Requirements ("Overline" Limit)

SBA received four comments on proposed § 107.740, under which a leveraged SBIC may not have more than 20 percent of its Regulatory Capital invested in or committed to a single Small Business or group of related businesses, unless SBA gives its prior written approval (for SSBICs, the limit is 30 percent of Regulatory Capital). The proposed rule was intended to address a problem faced by an SBIC which reduces its Regulatory Capital in a manner permitted by the regulations (such as when a Participating Securities issuer returns capital to its investors), and then finds that one or more of its existing investments now exceed its reduced overline limitation. SBA's proposed solution was to base a Licensee's maximum permitted investment in or commitment to a Small Business on its Regulatory Capital at the time the investment or commitment is made.

All of the commenters supported this change, but suggested that SBA go further. One commenter felt that an SBIC should have the ability to make follow-on investments in a Small Business based on the Licensee's Regulatory Capital at the time the initial investment was made. The other commenters argued more broadly that an SBIC, particularly a limited life partnership which expects to return capital to investors as investments are harvested, should be permitted to base its overline limit on its initial Regulatory Capital (assuming no further increases), with no reduction for any subsequent decreases in Regulatory Capital. The commenters all suggested that an SBIC should not be forced to reduce the intended investment size reflected in its business plan because of an early return of capital; one commenter pointed out that this imposes a penalty which is particularly unjustified in the case of an SBIC which makes a distribution resulting from a profitable realization of a portfolio company investment.

SBA understands these concerns, particularly with respect to an SBIC organized as a limited life partnership which does not reinvest capital. However, SBA believes that the suggested changes are prohibited by section 306(a) of the Act. Therefore, the proposed rule is finalized without change.

Cost of Money

SBA proposed three revisions to § 107.855, which sets forth limits on interest rates and other charges that SBICs may impose on Small Businesses, generally referred to as ''Cost of Money''. These provisions are finalized as proposed. Two of the changes dealt with the computation of the Cost of Money ceiling, mainly the circumstances under which Licensees may include in the computation the 1 percent additional charge on Leverage which is payable to SBA. The other change involved the treatment of detachable stock purchase warrants.

The four comments received on this section all strongly supported proposed § 107.855(g)(1), which contained an exclusion from Cost of Money for a discount on the loan portion of a Debt Security, if the discount results solely from the allocation of fair value to detachable stock purchase warrants as required by generally accepted accounting principles. One commenter suggested that the exclusion be extended to any discount resulting from the allocation of fair value to an equity feature of a Debt Security, without regard to whether the equity feature was in the form of a warrant, common stock or other equity equivalent. SBA did not expand the proposed language because it has not encountered this type of Cost of Money issue with equity features other than warrants; if such an issue arises in the future, the Agency will consider whether further change is desirable.

Control

Proposed § 107.865 contained two clarifications to the existing regulation concerning Control of a Small Business by an SBIC, which are finalized without change. SBA received one comment concerning proposed § 107.865(c), which set forth the circumstances under which a Licensee can rebut a presumption of Control. The comment did not specifically relate to the proposed change, which was merely an editorial clarification. It concerned the interpretation of the rebuttal condition in § 107.865(c)(2) which states, in part, that ''[m]anagement of the Small Business can elect at least 40 percent of the board members of a corporation, general partners of a limited partnership, or managers of a limited liability company, as appropriate, and the Investor Group can elect no more than 40 percent.''

The commenter provided the following scenario: There are five seats on the Small Business's board of directors, three to be filled by management and two by the Investor Group. One of the seats controlled by management is vacant, so the actual board composition represents a 50–50 split between management and the Investor Group. The commenter suggested that these circumstances satisfy the rebuttal condition in § 107.865(c)(2) because management can fill three of the five board seats (60 percent), while the Investor Group can fill the remaining two (40 percent). The vacant seat should not affect the rebuttal, because the management of the Small Business can exercise its right to fill the seat and assert control of the board at any time. As long as there are no restrictions on management's ability to do so, SBA agrees with this interpretation of the regulation and does not believe that any further clarification is needed.

Eligibility for Leverage and Leverage Commitments

Section 208 of Public Law 104–208 established certain requirements which an SBIC must satisfy in order to obtain SBA Leverage. These requirements are implemented by § 107.1120 (c) and (d), which are adopted without change from the proposed rule. Under these provisions, an SBIC licensed after September 30, 1996, with Regulatory Capital of less than $5,000,000 is ineligible for Leverage until it reaches the $5,000,000 level. An SBIC licensed on or before September 30, 1996, is not required to increase its capital in order to obtain additional Leverage; however, if its Regulatory Capital is less than $5,000,000 ($10,000,000 for a company seeking to issue Participating Securities), it must certify in writing that at least 50 percent of the aggregate dollar amount of its Financings

extended after September 30, 1996 will be provided to Smaller Enterprises (see also § 107.710(c)). Finally, any Licensee seeking Leverage must certify in writing that it is in compliance with the general requirement to provide 20 percent of its total Financings to Smaller Enterprises under § 107.710(b).

SBA is also finalizing without change the revisions proposed in §§ 107.1200, 107.1230 and 107.1240 to eliminate unnecessary limitations on the amounts of Leverage commitments and draws and to facilitate the interim Leverage funding mechanism which SBA is now developing.

Leverage Fees

SBA proposed changes in §§ 107.1130 and 107.1210 to implement provisions of section 208(d)(6) of Public Law 104–208 which affect the fees SBICs must pay in order to obtain SBA Leverage. Proposed § 107.1130 is adopted without change; however, § 107.1210 has been revised as a result of legislation enacted after publication of the proposed rule.

Under § 107.1130(a), a Licensee must pay a nonrefundable ''leverage fee'' to SBA when Debentures or Participating Securities are issued. The fee is 3 percent of the face amount of the Leverage issued, replacing the 2 percent user fee and the 1 percent commitment fee previously in effect. Section 107.1130(d) requires a Licensee to pay to SBA an additional ''Charge'' on Debentures and Participating Securities (see also § 107.50 for the definition of this new term). For both types of Leverage, the Charge is 1 percent per annum. The Charge is payable under the same terms and conditions as the interest on Debentures or the Prioritized Payments on Participating Securities, as applicable. Thus, a Debenture issuer would pay the Charge in two semi-annual installments together with its interest payments. In contrast, a Participating Securities issuer would pay the Charge only when it had profits and was distributing Prioritized Payments under § 107.1540. The Charge does not apply to Leverage drawn down against a commitment obtained from SBA on or before September 30, 1996.

Under proposed § 107.1210(a), if a Licensee received a Leverage commitment from SBA, it would have been required to prepay the 3 percent leverage fee at the time it received the commitment. However, section 215(d) of Public Law 105–135, enacted December 2, 1997, dividend payment of the leverage fee into two stages for Licensees which receive a Leverage commitment: A nonrefundable fee equal to 1 percent of the committed amount must be paid when the commitment is received, and 2 percent of the amount of each draw must be paid when funds are drawn down. To implement this statutory mandate, the final rule is modified accordingly.

Participating Securities—General

Proposed § 107.1500 is adopted without change. This section contains clarifications and minor revisions concerning the redemption and priority in liquidation of Participating Securities, and eliminates the requirement for a Licensee to maintain a specified level of Equity Capital Investments.

Liquidity Requirements for Participating Securities

The proposed rule included two minor changes to the liquidity requirements in § 107.1505. The section is finalized as proposed. SBA received two comments in support of the revised computation of the liquidity ratio in § 107.1505(b). Both commenters stated that the change in the weighting of publicly traded securities will simplify the computation and also will eliminate the ''double discounting'' of such securities.

Earmarked Profit (Loss)

Section 107.1510 is adopted as proposed. This section contains minor technical revisions intended to simplify the computation of Earmarked Profit (Loss) by Participating Securities issuers.

Prioritized Payments

Section 107.1520 tells a Licensee how to compute Prioritized Payments and how to determine whether it has profits which will cause Prioritized Payments to become ''earned'' and therefore payable to SBA. Four revisions to this section were proposed and are adopted without change.

First, the regulation implements a provision of Public Law 104–208 by including ''Charges'' (the 1 percent annual fee discussed in this preamble under the heading ''Leverage Fees'') on outstanding Participating Securities in the required computations. Although Charges are not part of Prioritized Payments, they are payable under the same terms and conditions.

Second, § 107.1520(a) incorporates a technical change intended to facilitate the interim Leverage funding mechanism currently under consideration by SBA.

Third, the computation of profit for the purposes of § 107.1520 is revised under § 107.1520(d). Under the previous regulation, a Licensee's ''profit'' was its cumulative Earmarked Profit minus its cumulative Earned Prioritized Payments from prior periods. This computation ignored the fact that some or all of the profit computed in this manner may have already been distributed under other sections of the regulations, either to SBA as Profit Participation or to the Licensee's private investors. The revised rule takes prior profit distributions into account in determining whether a Licensee has profits which can be used to pay Prioritized Payments. SBA received two comments in support of this change.

Finally, § 107.1520(f) provides additional detail concerning the computation of Adjustments, a type of compounding of unpaid Prioritized Payments.

Profit Participation

Section 107.1530 is adopted as proposed. SBA received two comments in support of the proposed regulation. The section contains several changes affecting the computation of Profit Participation, which must be allocated to SBA by a Participating Securities issuer when it has earned profits over and above the amount necessary to pay its Prioritized Payments in full. Profit Participation is determined by computing a ''Base'' and a ''Profit Participation Rate'', and multiplying the Base by the Rate. The rule revises the computation of the Base with respect to certain losses incurred by a Licensee in prior periods and provides a simpler method of computing the ''PLC ratio'', which is one of the variables in the Profit Participation Rate formula. The rationale for these changes is discussed in detail in the preamble to the proposed rule.

Tax Distributions

Proposed § 107.1550, which dealt with tax distributions by Participating Securities issuers organized as limited partnerships or similar flow-through entities, is adopted as final with one modification. The proposed changes consisted of clarifications and a minor technical revision, as discussed in the preamble to the proposed rule. In the final rule, SBA is incorporating one additional change to correct an error in § 107.1550(c)(3). The previous regulation stated that SBA would apply its share of any tax distribution to the Profit Participation owed by a Licensee under § 107.1530. However, there are certain circumstances under which SBA's share of a tax distribution may exceed the Profit Participation owed. In such cases, SBA will apply its share first to any Profit Participation, and then generally as a redemption of Participating Securities in order of issue

(in rare cases, a Licensee may owe other amounts which will be considered in the application of the distribution). The final rule incorporates this correction by indicating that SBA will apply its share of tax distributions in the same order specified for other profit-based distributions in § 107.1560(g).

Distributions Based on ''Retained Earnings Available for Distribution''

SBA proposed minor revisions in § 107.1560(a)(1), (a)(4), (b) and (e) which are finalized without change. These provisions clarify various aspects of the calculation of distributions by Participating Securities issuers who have Retained Earnings Available for Distribution remaining after paying Prioritized Payments and tax distributions.

Optional Distributions Not Based on READ

Proposed § 107.1570(b) is adopted without change. SBA received two comments in support of the proposed section, which dealt with conditions under which a Licensee which has no Retained Earnings Available for Distribution can make optional distributions to its private investors and SBA. Both commenters agreed with SBA that the change in § 107.1570(b)(1)(ii) removes an unintended limitation on Licensees' ability to make such distributions.

Notice of Participating Securities Distributions

The proposed rule included a prior notice requirement for all distributions by SBICs which have issued Participating Securities. SBA is finalizing as proposed the language establishing this requirement in §§ 107.1540 through 107.1570, which govern the various types of distributions. A Licensee must notify SBA 10 business days before any planned distribution, unless the Agency permits otherwise. SBA received one comment agreeing that such notification is appropriate given the complexity of the distribution rules. The commenter did not believe that the requirement would unreasonably constrain a Licensee's freedom of action.

Timing of Participating Securities Distributions

Section 107.1575 is adopted as proposed. SBA received three comments on the proposed rule, all of which supported the additional flexibility given to Participating Securities issuers wishing to make distributions on dates other than the established quarterly ''Payment Dates'' (February 1, May 1, August 1 and November 1 of each year).

All of the commenters raised one issue which may arise when a Licensee makes a distribution to SBA which includes a redemption of Participating Securities. The proposed rule specified that in such cases, the effective date of the redemption would be the next Payment Date following the distribution date; therefore, a Licensee would be responsible for Prioritized Payments through the next Payment Date on the amount of Participating Securities to be redeemed. SBA felt this provision was necessary because Participating Securities are funded through the purchase by investors of Trust Certificates, under which principal can be returned only on Payment Dates.

The commenters understood why SBA must continue to ''charge'' the Prioritized Payment on Participating Securities up to the next Payment Date, but asked whether SBA could provide a mechanism (such as an escrow provision) which would allow a Licensee to earn interest on any redemption payment that it distributes to SBA, from the date of distribution until the next Payment Date. SBA is sympathetic to this request and believes that the result would be fair both to Licensees and to the Agency. To facilitate such an arrangement, SBA is exploring the possibility of allowing SBICs to establish individual escrow accounts at a designated financial institution to hold the proceeds of distributions made on dates other than Payment Dates. The accounts would be for the benefit of SBA, but any interest income would inure to the benefit of the Licensee. Each SBIC would be responsible for any expenses incurred in establishing and maintaining its account. The use of an escrow account would be an option available to SBICs, but would not be required. SBA does not believe that such an arrangement requires a change in the regulations. SBA will provide further information to Licensees as soon as possible.

In-Kind Distributions by Licensees

SBA received three comments on proposed § 107.1580. The section sets forth the conditions under which a Participating Securities issuer can make distributions in the form of securities rather than cash. All of the commenters supported the proposed revision permitting a Licensee to pay Prioritized Payments under § 107.1540 via an in-kind distribution. Two of the commenters suggested that SBA also consider allowing SBICs to make tax distributions under § 107.1550 in the form of securities. SBA feels strongly that tax distributions should be made on a cash-only basis. As stated in the preamble to the proposed rule, the intent of such distributions is to provide investors in flow-through entities with sufficient cash to pay their anticipated tax liabilities, and an in-kind distribution does not satisfy this purpose. Therefore, the proposed rule is finalized without change.

Exchange of Debentures for Participating Securities

Proposed §§ 107.1585 and 107.1590 are finalized without change. In these sections, references to the retirement of Debentures through the issuance of Preferred Securities are eliminated, and provisions governing the retirement of Debentures through the issuance of Participating Securities are reorganized and reworded without substantive change.

Characteristics of SBA's Leverage Guarantee

Section 107.1720 is adopted as proposed. The section restores language setting forth the unconditional nature and other characteristics of SBA's guarantee which was inadvertently dropped in a previous regulatory revision.

Capital Impairment

Proposed § 107.1830(a) is finalized without change. The provision clarifies that SBA Leverage is subject to the Capital Impairment regulations in effect on the date the Leverage is issued. In addition, it requires a Licensee to comply with any specific conditions to which it has agreed by contract with SBA.

Miscellaneous Corrections and Editorial Changes

The proposed definition of ''Commitment'' in § 107.50 is finalized without change. The definition is reworded in the third person (*i.e.*, to refer to ''a Licensee'' instead of ''you'') to conform to the style in which the other definitions are written.

The proposed correction of the SIC code for Operative Builders in § 107.720(c) is adopted as final.

Proposed § 107.1600(a) is adopted as final. Under this provision, references to section 321 of the Act are changed to section 319, reflecting the amendment of the Act by Public Law 104–208. In addition, to implement section 215(e) of Public Law 105–135, § 107.1600(b) is revised to state that SBA will issue guarantees of Leverage and of Trust Certificates at intervals of not more than six months, rather than three months.

The proposed definition of Trust Certificate Rate is adopted as final. The definition incorporates certain technical changes to facilitate the interim funding mechanism currently under consideration by SBA.

Limited Liability Companies

Section 208(b)(1) of Public Law 104–208 amended the Act to permit SBICs to organize as limited liability companies (LLCs). SBA is studying the legal and administrative issues which may arise in connection with LLCs, and will publish a proposed rule to implement this form of organization by SBICs at a later date.

Although SBA regulations do not yet provide for LLC Licensees, SBA has the statutory authority to license such companies. SBA's current policy is to accept a license application from an LLC only if the LLC is organized under Delaware's Limited Liability Company Act and does not intend to issue Participating Securities, which SBA has not yet developed in a form suitable for use by an LLC. SBA may reconsider these limitations as SBA acquires greater familiarity with the LLC form of organization and as a body of case law is created under the various state LLC laws. The adoption of a Uniform LLC Act by a significant number of states also would induce SBA to reexamine its current preference for Delaware law.

Until SBA regulations are revised to accommodate LLC Licensees, such Licensees should understand that SBA regards the members of the LLC to be equivalent to the general partners in a partnership Licensee unless the LLC's operating agreement clearly indicates otherwise. Thus, all members of an LLC Licensee will automatically be considered Control Persons and Associates of the Licensee unless the LLC's operating agreement vests management authority only in certain members of the company.

Compliance With Executive Orders, 12612, 12778, and 12866, the Regulatory Flexibility Act (5 U.S.C. 601, et seq.), and the Paperwork Reduction Act (44 U.S.C. Ch. 35)

SBA certifies that this final rule will not be a significant regulatory action for purposes of Executive Order 12866 because it will not have an annual effect on the economy of more than $100 million, and that it will not have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act, 5 U.S.C. 601, *et seq.* The purpose of the rule is to implement provisions of Public Law 104–208 which relate to small business investment companies, and to make certain other changes, primarily technical corrections and clarifications, to the regulations governing SBICs.

For purposes of the Paperwork Reduction Act, 44 U.S.C. Ch. 35, SBA certifies that this final rule will contain no new reporting or recordkeeping requirements.

For purposes of Executive Order 12612, SBA certifies that this final rule will not have any federalism implications warranting the preparation of a Federalism Assessment.

For purposes of Executive Order 12778, SBA certifies that this final rule is drafted, to the extent practicable, in accordance with the standards set forth in Section 2 of that Order.

List of Subjects in 13 CFR Part 107

Investment companies, Loan programs—business, Reporting and recordkeeping requirements, Small businesses.

For the reasons set forth above, part 107 of title 13 of the Code of Federal Regulations is amended as follows:

PART 107—SMALL BUSINESS INVESTMENT COMPANIES

1. The authority citation for part 107 is revised to read as follows:

Authority: 15 U.S.C. 681 *et seq.*, 683, 687(c), 687b, 687d, 687g and 687m.

2. Section 107.50 is amended by revising the definitions for Commitment, Common Control, Preferred Securities, Section 301(d) Licensee, and Trust Certificate Rate, and adding in alphabetical order a definition of Charge, to read as follows:

§ 107.50 Definitions of terms.

* * * * *

Charge means an annual fee on Leverage issued on or after October 1, 1996 (except for Leverage issued pursuant to a commitment made by SBA before October 1, 1996), which is payable to SBA by Licensees, subject to the terms and conditions set forth in § 107.1130(d).

* * * * *

Commitment means a written agreement between a Licensee and an eligible Small Business that obligates the Licensee to provide Financing (except a guarantee) to that Small Business in a fixed or determinable sum, by a fixed or determinable future date. In this context the term ''agreement'' means that there has been agreement on the principal economic terms of the Financing. The agreement may include reasonable conditions precedent to the Licensee's obligation to fund the commitment, but these conditions must be outside the Licensee's control.

Common Control means a condition where two or more Persons, either through ownership, management, contract, or otherwise, are under the Control of one group or Person. Two or more Licensees are presumed to be under Common Control if they are Affiliates of each other by reason of common ownership or common officers, directors, or general partners; or if they are managed or their investments are significantly directed either by a common independent investment advisor or managerial contractor, or by two or more such advisors or contractors that are Affiliates of each other. This presumption may be rebutted by evidence satisfactory to SBA.

* * * * *

Preferred Securities means nonvoting preferred stock or nonvoting limited partnership interests issued to SBA prior to October 1, 1996, by a Section 301(d) Licensee. Such securities were issued at par value in the case of preferred stock, or at face value in the case of preferred limited partnership interests.

* * * * *

Section 301(d) Licensee means a company licensed prior to October 1, 1996 under section 301(d) of the Act as in effect on the date of licensing, that may provide Assistance only to Disadvantaged Businesses. A Section 301(d) Licensee may be organized as a for-profit corporation, as a non-profit corporation, or as a limited partnership.

* * * * *

Trust Certificate Rate means a fixed rate determined by the Secretary of the Treasury at the time Participating Securities or Debentures are pooled, taking into consideration the current average market yield on outstanding marketable obligations of the United States with maturities comparable to the maturities of the Trust Certificates being guaranteed by SBA, adjusted to the nearest one-eighth of one percent.

* * * * *

§ 107.110 [Removed]

3. Section 107.110 is removed.

4. Section 107.120 is revised to read as follows:

§ 107.120 Special rules for a Section 301(d) Licensee owned by another Licensee.

With SBA's prior written approval, a Section 301(d) Licensee may operate as the subsidiary of one or more Licensees (participant Licensees), subject to the following:

(a) Each participant Licensee must own at least 20 percent of the voting securities of the Section 301(d) Licensee.

(b) A participant Licensee must treat its entire capital contribution to the subsidiary as a reduction of its Leverageable Capital. The participant Licensee's remaining Leverageable Capital must be sufficient to support its outstanding Leverage.

(c) A participant Licensee may not transfer its Leverage to a subsidiary Section 301(d) Licensee.

5. In § 107.150, the introductory text of paragraph (a)(1) is revised to read as follows:

§ 107.150 Management and ownership diversity requirement.

* * * * *

(a) *Requirement one.* * * *

(1) At least 30 percent of your Regulatory Capital and Leverageable Capital must be owned by Persons unrelated to management. To satisfy this requirement, such Persons must not be your Associates (except for their status as your shareholders or limited partners) and must not Control, be Controlled by, or be under Common Control with any of your Associates. You must have as investors at least three such Persons who are not Affiliates of one another and whose investments are significant in both dollar and percentage terms, as determined by SBA. As an alternative, you may substitute one investor who is an acceptable Institutional Investor for the three investors who are otherwise required. For purposes of this paragraph (a)(1), the following Institutional Investors are acceptable:

* * * * *

6. Section 107.210 is revised to read as follows:

§ 107.210 Minimum capital requirements for Licensees.

(a) *Companies licensed on or after October 1, 1996.* A company licensed on or after October 1, 1996 must have Leverageable Capital of at least $2,500,000 and must meet the applicable minimum Regulatory Capital requirement:

(1) *Licensees other than Participating Securities issuers.* A Licensee that does not wish to be eligible to apply for Participating Securities must have Regulatory Capital of at least $5,000,000. As an exception to this general rule, SBA in its sole discretion and based on a showing of special circumstances and good cause may license an applicant with Regulatory Capital of at least $3,000,000, but only if the applicant:

(i) Has satisfied all licensing standards and requirements except the minimum capital requirement, as determined solely by SBA;

(ii) Has a viable business plan reasonably projecting profitable operations; and

(iii) Has a reasonable timetable for achieving Regulatory Capital of at least $5,000,000.

(2) *Participating Securities issuers.* A Licensee that wishes to be eligible to apply for Participating Securities must have Regulatory Capital of at least $10,000,000, unless it demonstrates to SBA's satisfaction that it can be financially viable over the long term with a lower amount. Under no circumstances can the Licensee have Regulatory Capital of less than $5,000,000.

(b) *Companies licensed before October 1, 1996.* A company licensed before October 1, 1996 must meet the minimum capital requirements applicable to such company, as required by the regulations in effect on September 30, 1996. See § 107.1120(c)(2) for Leverage eligibility requirements.

§ 107.220 [Removed]

7. Section 107.220 is removed.

8. Section 107.230 is amended by revising the introductory text of paragraph (d)(4) to read as follows:

§ 107.230 Permitted sources of Private Capital for Licensees.

* * * * *

(d) *Qualified Non-private Funds.*

* * *

(4) Funds invested in or committed in writing to any Section 301(d) Licensee prior to October 1, 1996, from the following sources:

* * * * *

9. In § 107.503, paragraphs (a), (b) and (e), and the heading and first sentence of paragraph (c), are revised to read as follows:

§ 107.503 Licensee's adoption of an approved valuation policy.

(a) *Valuation guidelines.* You must prepare, document and report the valuations of your Loans and Investments in accordance with the Valuation Guidelines for SBICs issued by SBA. These guidelines may be obtained from SBA's Investment Division.

(b) *SBA approval of valuation policy.* You must have a written valuation policy approved by SBA for use in determining the value of your Loans and Investments. You must either:

(1) Adopt without change the model valuation policy set forth in section III of the Valuation Guidelines for SBICs; or

(2) Obtain SBA's prior written approval of an alternative valuation policy.

(c) *Responsibility for valuations.* Your board of directors or general partner(s) will be solely responsible for adopting your valuation policy and for using it to prepare valuations of your Loans and Investments for submission to SBA.

* * *

* * * * *

(e) *Review of valuations by independent public accountant.* (1) For valuations performed as of the end of your fiscal year, your independent public accountant must review your valuation procedures and the implementation of such procedures, including adequacy of documentation.

(2) The independent public accountant's report on your audited annual financial statements (SBA Form 468) must include a statement that your valuations were prepared in accordance with your approved valuation policy established in accordance with section 310(d)(2) of the Act.

10. Section 107.660 is amended by redesignating paragraph (d) as paragraph (e) and by adding a new paragraph (d) to read as follows:

§ 107.660 Other items required to be filed by Licensee with SBA.

* * * * *

(d) *Notification of criminal charges.* If any officer, director, or general partner of the Licensee, or any other person who was required by SBA to complete a personal history statement in connection with your license, is charged with or convicted of any criminal offense other than a misdemeanor involving a minor motor vehicle violation, you must report the incident to SBA within 5 calendar days. Such report must fully describe the facts which pertain to the incident.

* * * * *

11. Section 107.710 is amended by adding a sentence at the end of paragraph (e) and by revising paragraphs (b) and (c) to read as follows:

§ 107.710 Requirement to Finance Smaller Enterprises.

* * * * *

(b) *Smaller Enterprise Financings.*—(1) *General rule.* At the close of each of your fiscal years, at least 20 percent of the total dollar amount of the Financings you extended since April 25, 1994 must have been invested in Smaller Enterprises. If you were licensed after April 25, 1994, the 20 percent requirement applies to the total dollar amount of the Financings you

extended since you were licensed plus any pre-licensing investments approved by SBA for inclusion in your Regulatory Capital.

(2) *Phase-in for new Licensees.* At the close of your first full fiscal year after licensing, at least 10 percent of the total dollar amount of the Financings you extended, including any pre-licensing investments approved by SBA for inclusion in your Regulatory Capital, must have been invested in Smaller Enterprises. At the close of each fiscal year thereafter, you must meet the requirement in paragraph (b)(1) of this section.

(c) *Special requirement for certain leveraged Licensees.*—(1) This paragraph (c) applies if you were licensed on or before September 30, 1996, and you issued Leverage after that date, and you have Regulatory Capital of:

(i) Less than $10,000,000 if such Leverage was Participating Securities; or

(ii) Less than $5,000,000 if such Leverage was Debentures.

(2) At the close of each of your fiscal years, at least 50 percent of the total dollar amount of the Financings you extended after September 30, 1996 must have been invested in Smaller Enterprises.

* * * * *

(e) *Non-compliance with this section.* * * * However, you will not be eligible for additional Leverage until you reach the required percentage (see § 107.1120(c) and (d)).

12. In § 107.720, paragraph (b)(2) is revised, paragraph (b)(3) is added, and the introductory text of paragraph (c)(1) is revised to read as follows:

§ 107.720 Small Businesses that may be ineligible for Financing.

* * * * *

(b) *Passive Businesses.* * * *

(2) *Exception for pass-through of proceeds to subsidiary.* You may finance a passive business if it is a Small Business and it passes substantially all the proceeds through to one or more subsidiary companies, each of which is an eligible Small Business that is not passive. For the purpose of this paragraph (b)(2), ''subsidiary company'' means a company in which at least 50 percent of the outstanding voting securities are owned by the Financed passive business.

(3) *Exception for certain Partnership Licensees.* With the prior written approval of SBA, if you are a Partnership Licensee, you may form one or more wholly-owned corporations in accordance with this paragraph (b)(3). The sole purpose of such corporation(s) must be to provide Financing to one or more eligible, unincorporated Small Businesses. You may form such corporation(s) only if a direct Financing to such Small Businesses would cause any of your investors to incur unrelated business taxable income under section 511 of the Internal Revenue Code of 1986, as amended (26 U.S.C. 511). Your ownership of such corporation(s) will not constitute a violation of § 107.865(a) and your investment of funds in such corporation(s) will not constitute a violation of § 107.730(a).

(c) *Real Estate Businesses.* (1) You are not permitted to finance any business classified under Major Group 65 (Real Estate) or Industry No. 1531 (Operative Builders) of the SIC Manual, with the following exceptions:

* * * * *

13. In § 107.730, paragraph (d)(3)(iv) is revised to read as follows:

§ 107.730 Financings which constitute conflicts of interest.

* * * * *

(d) *Financings with Associates.* * * *

(3) *Exceptions to paragraphs (d)(1) and (d)(2) of this section.* * * *

(iv) Both you and your Associate are non-leveraged Licensees, or you are a non-leveraged Licensee and your Associate is not a Licensee.

* * * * *

14. In § 107.740, paragraph (a) is revised to read as follows:

§ 107.740 Portfolio diversification (''overline'' limitation).

(a) *General rule.* This § 107.740 applies if you have outstanding Leverage or want to be eligible for Leverage. Without SBA's prior written approval, you may provide Financing or a Commitment to a Small Business only if the resulting amount of your aggregate outstanding Financings and Commitments to such Small Business and its Affiliates does not exceed:

(1) 20 percent of your Regulatory Capital as of the date of the Financing or Commitment if you are a Section 301(c) Licensee; or

(2) 30 percent of your Regulatory Capital as of the date of the Financing or Commitment if you are a Section 301(d) Licensee.

* * * * *

15. Section 107.855 is amended by revising paragraphs (c)(1), (c)(4)(i) and (d)(4), redesignating paragraphs (g)(1) through (g)(10) as paragraphs (g)(2) through (g)(11), and adding a new paragraph (g)(1) to read as follows:

§ 107.855 Interest rate ceiling and limitations on fees charged to Small Businesses (''Cost of Money'').

* * * * *

(c) *How to determine the Cost of Money ceiling for a Financing.* * * *

(1) Choose a base rate for your Cost of Money computation. The base rate may be either the Debenture Rate currently in effect plus the applicable Charge determined under § 107.1130(d)(1), or your own ''Cost of Capital'' as determined under paragraph (d) of this section.

* * * * *

(4) * * *

(i) The current Debenture Rate plus the applicable Charge determined under § 107.1130(d)(1);

* * * * *

(d) *How to determine your Cost of Capital.* * * *

(4) For all qualified borrowings outstanding at your last fiscal year or fiscal quarter end, determine the aggregate interest expense for the past four fiscal quarters, excluding amortization of loan fees. For the purposes of this paragraph (d)(4):

(i) Interest expense on Debentures includes the 1 percent Charge paid by a Licensee under § 107.1130(d)(1); and

(ii) Section 301(d) Licensees with outstanding subsidized Debentures are presumed to have paid interest at the rate stated on the face of such Debentures, without regard to any subsidy paid by SBA.

* * * * *

(g) *Charges excluded from the Cost of Money.* * * *

(1) Discount on the loan portion of a Debt Security, if such discount exists solely as the result of the allocation of value to detachable stock purchase warrants in accordance with generally accepted accounting principles.

* * * * *

16. In § 107.865, the first sentence of paragraph (c)(2) and paragraph (d)(1) are revised to read as follows:

§ 107.865 Restrictions on Control of a Small Business by a Licensee.

* * * * *

(c) *Rebuttals to presumption of Control.* * * *

(2) The management of the Small Business can elect at least 40 percent of the board members of a corporation, general partners of a limited partnership, or managers of a limited liability company, as appropriate, and the Investor Group can elect no more than 40 percent. * * *

* * * * *

(d) *Temporary Control permitted.* * * *

(1) Where reasonably necessary for the protection of your existing investment;

* * * * *

17. Section 107.1100 is revised to read as follows:

§ 107.1100 Types of Leverage and application forms.

(a) *Types of Leverageable available.* You may apply for Leverage from SBA in one or both of the following forms:

(1) The purchase or guarantee of your Debentures.

(2) The purchase or guarantee of your Participating Securities.

(b) *Application forms.* Use SBA Form 1022 to apply for Debentures and SBA Form 1022B to apply for Participating Securities.

(c) *Where to send your application.* Send all Leverage applications to SBA, Investment Division, 409 Third Street, S.W., Washington, DC 20416.

§ 107.1110 [Removed]

18. Section 107.1110 is removed.

19. Section 107.1120 is amended by revising paragraph (c), redesignating paragraphs (d) through (f) as paragraphs (e) through (g), and adding a new paragraph (d) to read as follows:

§ 107.1120 General eligibility requirements for Leverage.

* * * * *

(c) Meet the minimum capital requirements of § 107.210, subject to the following additional conditions:

(1) If you were licensed after September 30, 1996 under the exception in § 107.210(a)(1), you will not be eligible for Leverage until you have Regulatory Capital of at least $5,000,000.

(2) If you were licensed on or before September 30, 1996, and have Regulatory Capital of less than $5,000,000 (less than $10,000,000 if you wish to issue Participating Securities):

(i) You must certify in writing that at least 50 percent of the aggregate dollar amount of your Financings extended after September 30, 1996 will be provided to Smaller Enterprises (as defined in § 107.710(a)); and

(ii) You must demonstrate to SBA's satisfaction that the approval of Leverage will not create or contribute to an unreasonable risk of default or loss to the United States government, based on such measurements of profitability and financial viability as SBA deems appropriate.

(d) Certify in writing that you are in compliance with the requirement to finance Smaller Enterprises in § 107.710(b).

* * * * *

20. Section 107.1130 is amended by revising the section heading and paragraphs (a) through (c), redesignating paragraph (d) as paragraph (e), and adding a new paragraph (d) to read as follows:

§ 107.1130 Leverage fees and additional charges payable by Licensee.

(a) *Leverage fee.* You must pay a leverage fee to SBA for each issuance of a Debenture or Participating Security. The fee is 3 percent of the face amount of the Leverage issued.

(b) *Payment of leverage fee.* (1) If you issue a Debenture or Participating Security to repay or redeem existing Leverage, you must pay the leverage fee before SBA will guarantee or purchase the new Leverage security.

(2) If you issue a Debenture or Participating Security that is not used to repay or redeem existing Leverage, SBA will deduct the leverage fee from the proceeds remitted to you, unless you prepaid the fee under § 107.1210.

(c) *Refundability.* The leverage fee is not refundable under any circumstances.

(d) *Additional charge for Leverage.*—(1) *Debentures.* You must pay to SBA a Charge of 1 percent per annum on the outstanding amount of your Debentures issued on or after October 1, 1996, payable under the same terms and conditions as the interest on the Debentures. This Charge does not apply to Debentures issued pursuant to a Leverage commitment obtained from SBA on or before September 30, 1996.

(2) *Participating Securities.* You must pay to SBA a Charge of 1 percent per annum on the outstanding amount of your Participating Securities issued on or after October 1, 1996, payable under the same terms and conditions as the Prioritized Payments on the Participating Securities. This Charge does not apply to Participating Securities issued pursuant to a Leverage commitment obtained from SBA on or before September 30, 1996.

* * * * *

21. Section 107.1160 is amended by adding introductory text to read as follows:

§ 107.1160 Maximum amount of Leverage for a Section 301(d) Licensee.

This section applies to Leverage issued by a Section 301(d) Licensee on or before September 30, 1996. Effective October 1, 1996, a Section 301(d) Licensee may apply to issue new Leverage, or refinance existing Leverage, only on the same terms permitted under § 107.1150.

* * * * *

22. Section 107.1200 is amended by revising paragraphs (c) and (d) to read as follows:

§ 107.1200 SBA's Leverage commitment to a Licensee—application procedure, amount, and term.

* * * * *

(c) *Limitations on the amount of a Leverage commitment.* The amount of a Leverage commitment must be a multiple of $5,000.

(d) *Term of Leverage commitment.* SBA's Leverage commitment will automatically lapse on the expiration date stated in the commitment letter issued to you by SBA.

23. Section 107.1210 is revised to read as follows:

§ 107.1210 Payment of leverage fee upon receipt of commitment.

(a) *Partial prepayment of leverage fee.* As a condition of SBA's Leverage commitment, and before you draw any Leverage under such commitment, you must pay to SBA a non-refundable fee equal to 1 percent of the face amount of the Debentures or Participating Securities reserved under the commitment. This amount represents a partial prepayment of the 3 percent leverage fee established under § 107.1130(a).

(b) *Automatic cancellation of commitment.* Unless you pay the fee required under paragraph (a) of this section by 5:00 P.M. Eastern Time on the 30th calendar day following the issuance of SBA's Leverage commitment, the commitment will be automatically canceled.

24. In § 107.1230, paragraphs (a) and (b) are revised to read as follows:

§ 107.1230 Draw-downs by Licensee under SBA's Leverage commitment.

(a) *Licensee's authorization of SBA to purchase or guarantee securities.* By submitting a request for a draw against SBA's Leverage commitment, you authorize SBA, or any agent or trustee SBA designates, to guarantee your Debenture or Participating Security and to sell it with SBA's guarantee.

(b) *Limitations on amount of draw.* The amount of a draw must be a multiple of $5,000. SBA, in its discretion, may determine a minimum dollar amount for draws against SBA's Leverage commitments. Any such minimum amounts will be published in Notices in the **Federal Register** from time to time.

* * * * *

25. Section 107.1240 is amended by revising paragraphs (a)(1), (b), (c) and (d) to read as follows:

§ 107.1240 Funding of Licensee's draw request through sale to short-term investor.

(a) *Licensee's authorization of SBA to arrange sale of securities to short-term investor.* * * *

(1) The sale of your Debenture or Participating Security to a short-term investor at a rate that may be different from the Trust Certificate Rate which will be established at the time of the pooling of your security;

* * * * *

(b) *Sale of Debentures to a short-term investor.* If SBA sells your Debenture to a short-term investor:

(1) The sale price will be the face amount.

(2) At the next scheduled date for the sale of Debenture Trust Certificates, whether or not the sale actually occurs, you must pay interest to the short-term investor for the short-term period. If the actual sale of Trust Certificates takes place after the scheduled date, you must pay the short-term investor interest from the scheduled sale date to the actual sale date. This additional interest is due on the actual sale date.

(3) Failure to pay the interest constitutes noncompliance with the terms of your Leverage (see § 107.1810).

(c) *Sale of Participating Securities to a short-term investor.* If SBA sells your Participating Security to a short-term investor, the sale price will be the face amount.

(d) *Licensee's right to repurchase its Debentures before pooling.* You may repurchase your Debentures from the short-term investor before they are pooled. To do so, you must:

(1) Give SBA written notice at least 10 days before the cut-off date for the pool in which your Debenture is to be included; and

(2) Pay the face amount of the Debenture, plus interest, to the short-term investor.

§ 107.1350 [Redesignated as § 107.1585]

26. Subpart I of Part 107 is amended by removing the undesignated center heading ''Exchange of Outstanding Debentures for Participating or Preferred Securities—Section 301(d) Licensees'' preceding § 107.1350, by redesignating § 107.1350 as § 107.1585 and revising it to read as follows:

§ 107.1585 Exchange of Debentures for Participating Securities.

You may, in SBA's discretion, retire a Debenture through the issuance of Participating Securities. To do so, you must:

(a) Obtain SBA's approval to issue Participating Securities;

(b) Pay all unpaid accrued interest on the Debenture, plus any applicable prepayment penalties, fees, and other charges;

(c) Have outstanding Equity Capital Investments (at cost) equal to the amount of the Debenture being refinanced; and

(d) Classify all your existing Loans and Investments as Earmarked Assets.

27. In § 107.1400, the section heading and introductory text are revised to read as follows:

§ 107.1400 Dividends or partnership distributions on 4 percent Preferred Securities.

If you issued Preferred Securities to SBA on or after November 21, 1989, you must pay SBA a dividend or partnership distribution of 4 percent per year, from the date you issued Preferred Securities to the date you repay them, both inclusive. The dividend or partnership distribution is:

* * * * *

28. Section 107.1420 is revised to read as follows:

§ 107.1420 Articles requirements for 4 percent Preferred Securities.

If you have outstanding 4 percent Preferred Securities, your Articles must contain all the provisions in §§ 107.1400 and 107.1410.

§ 107.1430 [Amended]

29. Section § 107.1430 is amended by removing the last sentence.

30. In § 107.1500, paragraphs (b)(1) and (b)(4), the last sentence of paragraph (e), and paragraph (f)(2) are revised to read as follows:

§ 107.1500 General description of Participating Securities.

* * * * *

(b) *Special eligibility requirements for Participating Securities.* * * *

(1) Minimum capital (see § 107.210).

* * * * *

(4) Equity investing, as set forth in this paragraph (b)(4). If you issue Participating Securities, you must invest an amount equal to the Original Issue Price of such securities solely in Equity Capital Investments, as defined in § 107.50.

* * * * *

(e) *Mandatory redemption of Participating Securities.* * * * *You must pay the Redemption Price plus any unpaid Earned Prioritized Payments and any earned Adjustments and earned Charges (see § 107.1520).*

(f) *Priority of Participating Securities in liquidation of Licensee.* * * *

(2) Any Earned Prioritized Payments and any earned Adjustments and earned Charges (see § 107.1520); and

* * * * *

31. In § 107.1505, paragraphs (a)(1) through (a)(3) are added and the last sentence of paragraph (a) introductory text and paragraph (b) are revised to read as follows:

§ 107.1505 Liquidity requirements for Licensees issuing Participating Securities.

* * * * *

(a) *Definition of Liquidity Impairment.* * * * You are responsible for calculating whether you have a condition of Liquidity Impairment:

(1) As of the close of your fiscal year;

(2) At the time you apply for Leverage, unless SBA permits otherwise; and

(3) At such time as you contemplate making any Distribution.

(b) *Computation of Liquidity Ratio.* Your Liquidity Ratio equals your Total Current Funds Available (A) divided by your Total Current Funds Required (B), as determined in the following table:

CALCULATION OF LIQUIDITY RATIO

Financial account	Amount reported on SBA form 468	Weight	Weighted amount
(1) Cash and invested idle funds		×1.00	
(2) Commitments from investors		×1.00	
(3) Current maturities		×0.50	
(4) Other current assets		×1.00	
(5) Publicly Traded and Marketable Securities		×1.00	
(6) Anticipated operating revenue for next 12 months	(1)	×1.00	
(7) Total Current Funds Available			A
(8) Current liabilities		×1.00	
(9) Commitments to Small Businesses		×0.75	
(10) Anticipated operating expense for next 12 months	(1)	×1.00	

CALCULATION OF LIQUIDITY RATIO—Continued

Financial account	Amount reported on SBA form 468	Weight	Weighted amount
(11) Anticipated interest expense for next 12 months	[1]	×1.00	
(12) Contingent liabilities (guarantees)		×0.25	
(13) Total Current Funds Required			B

[1] As determined by Licensee's management under its business plan.

32. In § 107.1510, the introductory text, the last sentence of paragraph (c) introductory text, the formula in paragraph (c), and paragraph (d)(1)(ii) are revised to read as follows:

§ 107.1510 How a Licensee computes Earmarked Profit (Loss).

Computing your Earmarked Profit (Loss) is the first step in determining your obligations to pay Prioritized Payments, Adjustments and Charges under § 107.1520 and Profit Participation under § 107.1530.

* * * * *

(c) *How to compute your Earmarked Asset Ratio.* * * * Otherwise, compute your Earmarked Asset Ratio using the following formula:

$EAR = (EA \div LI) \times 100$

where:

EAR = Earmarked Asset Ratio.
EA = Average Earmarked Assets (at cost) for the fiscal year or interim period.
LI = Average Loans and Investments (at cost) for the fiscal year or interim period.

(d) *How to compute your Earmarked Profit (Loss) if Earmarked Asset Ratio is 100 percent.*

(1) * * *

(ii) For the purpose of determining Net Income (Loss), leverage fees paid to SBA and partnership syndication costs that you incur must be capitalized and amortized on a straight-line basis over not less than five years.

* * * * *

33. Section 107.1520 is revised to read as follows:

§ 107.1520 How a Licensee computes and allocates Prioritized Payments to SBA.

This section tells you how to compute Prioritized Payments, Adjustments and Charges on Participating Securities and determine the amounts you must pay. To distribute these amounts, see § 107.1540.

(a) *How to compute Prioritized Payments and Adjustments*—(1) *Prioritized Payments.* For a full fiscal year, the Prioritized Payment on an outstanding Participating Security equals the Redemption Price times the related Trust Certificate Rate. For an interim period, you must prorate the annual Prioritized Payment. If your Participating Security was sold to a short-term investor in accordance with § 107.1240, the Prioritized Payment for the short-term period equals the Redemption Price times the short-term rate.

(2) *Adjustments.* Compute Adjustments using paragraph (f) of this section.

(3) *Charges.* Compute Charges in accordance with § 107.1130(d)(2).

(b) *Licensee's obligation to pay Prioritized Payments, Adjustments and Charges.* You are obligated to pay Prioritized Payments, Adjustments and Charges only if you have profit as determined in paragraph (d) of this section.

(1) Prioritized Payments that you must pay (or have already paid) because you have sufficient profit are ''Earned Prioritized Payments''.

(2) Prioritized Payments that have not become payable because you lack sufficient profit are ''Accumulated Prioritized Payments''. Treat all Prioritized Payments as ''Accumulated'' until they become ''Earned'' under this section.

(3) Adjustments (computed under paragraph (f) of this section) and Charges (computed under § 107.1130(d)(2)) are ''earned'' according to the same criteria applied to Prioritized Payments.

(c) *How to keep track of Prioritized Payments.* You must establish three accounts to record your Accumulated and Earned Prioritized Payments:

(1) *Accumulation Account.* The Accumulation Account is a memorandum account. Its balance represents your Accumulated Prioritized Payments, unearned Adjustments and unearned Charges.

(2) *Distribution Account.* The Distribution Account is a liability account. Its balance represents your unpaid Earned Prioritized Payments, earned Adjustments and earned Charges.

(3) *Earned Payments Account.* The Earned Payments Account is a memorandum account. Each time you add to the Distribution Account balance, add the same amount to the Earned Payments Account. Its balance represents your total (paid and unpaid) Earned Prioritized Payments, earned Adjustments and earned Charges.

(d) *How to determine your profit for Prioritized Payment purposes.* As of the end of each fiscal year and any interim period for which you want to make a Distribution:

(1) Bring the Accumulation Account up to date by adding to it all Prioritized Payments and Charges through the end of the appropriate fiscal period.

(2) Determine whether you have profit for the purposes of this section by doing the following computation:

(i) Cumulative Earmarked Profit (Loss) under § 107.1510(f); minus

(ii) The Earned Payments Account balance; minus

(iii) All Distributions previously made under §§ 107.1550, 107.1560 and 107.1570(a); minus

(iv) Any Profit Participation previously allocated to SBA under § 107.1530, but not yet distributed.

(3) The amount computed in paragraph (d)(2) of this section, if greater than zero, is your profit. If the amount is zero or less, you have no profit.

(4) If you have a profit, continue with paragraph (e) of this section. Otherwise, continue with paragraph (f) of this section.

(e) *Allocating Prioritized Payments to the Distribution Account.* (1) If you have a profit under paragraph (d) of this section, determine the lesser of:

(i) Your profit; or

(ii) The balance in your Accumulation Account.

(2) Subtract the result in paragraph (e)(1) of this section from the Accumulation Account and add it to the Distribution Account and the Earned Payments Account.

(f) *How to compute Adjustments.* You must compute Adjustments as of the end of each fiscal year if you have a balance greater than zero in either your Accumulation Account or your Distribution Account, after giving effect to any Distribution that will be made no

later than the second Payment Date following the fiscal year end.

(1) Determine the combined average Accumulation Account and Distribution Account balances for the fiscal year, assuming that Prioritized Payments accumulate on a daily basis without compounding.

(2) Multiply the average balance computed in paragraph (f)(1) of this section by the average of the Trust Certificate Rates for all the Participating Securities poolings during the fiscal year.

(3) Add the amounts computed in this paragraph (f) to your Accumulation Account.

(g) *Licensee's obligation to pay Prioritized Payments after redeeming Participating Securities.* This paragraph (g) applies if you have redeemed all your Participating Securities, but you still hold Earmarked Assets and still have a balance in your Accumulation Account.

(1) You must continue to perform all the procedures in this section as of the end of each fiscal quarter and prior to making any Distribution. You must distribute any Earned Prioritized Payments, earned Adjustments and earned Charges in accordance with § 107.1540.

(2) After you dispose of all your Earmarked Assets and make any required Distributions in accordance with § 107.1540, your obligation to pay any remaining Accumulated Prioritized Payments, unearned Adjustments and unearned Charges will be extinguished.

34. Section 107.1530 is amended by removing paragraphs (e)(3) and (e)(4) and revising paragraphs (c), (e)(2) and (h) to read as follows:

§ 107.1530 How a Licensee computes SBA's Profit Participation.

* * * * *

(c) *How to compute the Base.* As of the end of each fiscal year and any year-to-date interim period for which you want to make a Distribution, compute your Base using the following formula:

$$B = EP - PPA - UL$$

where:

B = Base.

EP = Earmarked Profit (Loss) for the period from § 107.1510.

PPA = Prioritized Payments for the period from § 107.1520(a)(1), Adjustments (if applicable) from § 107.1520(f), and Charges (if applicable) from § 107.1130(d)(2).

UL = ''Unused Loss'' from prior periods as determined in this paragraph (c).

(1) If the Base computed as of the end of your previous fiscal year (your ''Previous Base'') was less than zero, your Unused Loss equals your Previous Base.

(2) If your Previous Base was zero or greater, your Unused Loss equals zero, with the following exception: If you made an interim Distribution of Profit Participation during your previous fiscal year, and your Previous Base was lower than the interim Base on which your Distribution was computed, then your Unused Loss equals the difference between the interim Base and the Previous Base. For example, assume you are computing your Base as of December 31, 1997, your fiscal year end. Your Previous Base, computed as of December 31, 1996, was $3,000,000. During 1996, you made an interim Distribution which was computed on a Base of $3,500,000 as of June 30, 1996. The $500,000 difference between the 1996 interim and year-end Bases would be carried forward as Unused Loss in the computation of your Base as of December 31, 1997.

(3) If you had no Participating Securities outstanding as of the end of your last fiscal year, you may request SBA's approval to treat your Undistributed Net Realized Loss, as reported on SBA Form 468 for that year, as Unused Loss. If you did not file SBA Form 468 because you were not yet licensed as of the end of your last fiscal year, you may request SBA's approval to treat pre-licensing losses as Unused Loss.

* * * * *

(e) *Compute the ''PLC ratio''.* * * *

(2) *Exception.* You may reduce the ratio computed under paragraph (e)(1) of this section if you have increased your Leverageable Capital above its highest previous level. The increase must have taken place at least 120 days before the date as of which your Base is computed. In addition, the increase must have been expressly provided for in a plan of operations submitted to and approved by SBA in writing, or must be the result of the takedown of commitments or the conversion of non-cash assets that were included in your Private Capital. If these conditions are satisfied, compute your reduced PLC ratio as follows:

(i) Divide the highest dollar amount of Participating Securities you have ever had outstanding by your increased Leverageable Capital.

(ii) If the result in paragraph (e)(2)(i) of this section is lower than your PLC ratio currently in effect, such result will become your new PLC ratio.

* * * * *

(h) *Computing SBA's Profit Participation.* If the Base from paragraph (c) of this section is greater than zero, you must compute SBA's Profit Participation as follows:

(1) Multiply the Base from paragraph (c) of this section by the Profit Participation Rate from paragraph (g) of this section.

(2) If your last Profit Participation computation was for an interim period during the same fiscal year and used a higher Profit Participation Rate than the Rate you just used in paragraph (h)(1) of this section, you must adjust the amount computed in paragraph (h)(1) of this section as follows:

(i) Determine the difference between the Profit Participation Rate you just used in paragraph (h)(1) of this section and the Rate used in your previous computation;

(ii) Multiply the difference by the Base from your last Profit Participation computation; and

(iii) Add the result to the amount you computed in paragraph (h)(1) of this section.

(3) Reduce the Profit Participation computed in paragraphs (h)(1) and (h)(2) of this section by any amounts of Profit Participation that you distributed or reserved for distribution to SBA, or its designated agent or Trustee, for any previous interim period(s) during the fiscal year. The result is SBA's Profit Participation (unless it is less than zero, in which case SBA's Profit Participation is zero).

* * * * *

35. Section 107.1540 is amended by adding a sentence at the end of the introductory text to read as follows:

§ 107.1540 Distributions by Licensee—Prioritized Payment and Adjustments.

* * * You must notify SBA of any planned distribution under this section 10 business days before the distribution date, unless SBA permits otherwise.

* * * * *

36. Section 107.1550 is amended by adding a sentence at the end of the introductory text and by revising paragraphs (a)(1), (b) and (c)(3) to read as follows:

§ 107.1550 Distributions by Licensee—permitted ''tax Distributions'' to private investors and SBA.

* * * You must notify SBA of any planned distribution under this section 10 business days before the distribution date, unless SBA permits otherwise.

(a) *Conditions for making a tax Distribution.* * * *

(1) You have paid all your Prioritized Payments, Adjustments, and Charges, so that the balance in both your Distribution Account and your

Accumulation Account is zero (see § 107.1520).

* * * * *

(b) *How to compute the Maximum Tax Liability.* (1) Compute your Maximum Tax Liability for a full fiscal year only. Use the following formula:

$M=(TOI \times HRO) + (TCG \times HRC)$

where:

M=Maximum Tax Liability.

TOI=Net ordinary income allocated to your partners or other owners for Federal income tax purposes for the fiscal year immediately preceding the Distribution, excluding Prioritized Payments allocated to SBA.

HRO=The highest combined marginal Federal and State income tax rate for corporations or individuals on ordinary income, determined in accordance with paragraphs (b)(2) through (b)(4) of this section.

TCG=Net capital gains allocated to your partners or other owners for Federal income tax purposes for the fiscal year immediately preceding the Distribution, excluding Prioritized Payments allocated to SBA.

HRC=The highest combined marginal Federal and State income tax rate for corporations or individuals on capital gains, determined in accordance with paragraphs (b)(2) through (b)(4) of this section.

(2) You may compute the highest combined marginal Federal and State income tax rate on ordinary income and capital gains using either individual or corporate rates. However, you must apply the same type of rate, either individual or corporate, to both ordinary income and capital gains.

(3) In determining the combined Federal and State income tax rate, you must assume that State income taxes are deductible from Federal income taxes. For example, if the Federal tax rate was 35 percent and the State tax rate was 5 percent, the combined tax rate would be [35% × (1 − .05)] + 5% = 38.25%.

(4) For purposes of this paragraph (b), the ''State income tax'' is that of the State where your principal place of business is located, and does not include any local income taxes.

(c) *SBA's share of the tax Distribution.*

* * * * *

(3) SBA will apply its share of the tax Distribution in the order set forth in § 107.1560(g).

* * * * *

37. In § 107.1560, in the first column of the table in paragraph (e), the column heading is revised to read ''If your ratio of Leverage to Leverageable Capital as of the fiscal period end is:'', a sentence is added at the end of the introductory text, and paragraphs (a)(1), (a)(4) and (b) are revised to read as follows:

§ 107.1560 Distributions by Licensee—required Distributions to private investors and SBA.

* * * You must notify SBA of any planned distribution under this section 10 business days before the distribution date, unless SBA permits otherwise.

(a) *Conditions for making Distributions.*

* * * * *

(1) You must have paid all Prioritized Payments, Adjustments and Charges, so that the balance in both your Distribution Account and your Accumulation Account is zero (see §§ 107.1520 and 107.1540).

* * * * *

(4) The amount you distribute under this section must not exceed your remaining Retained Earnings Available for Distribution.

(b) *Total amount you must distribute.* Unless SBA permits otherwise, the total amount you must distribute equals the result (if greater than zero) of the following computation:

(1) Your Retained Earnings Available for Distribution as of the end of your fiscal year, after giving effect to any Distribution under §§ 107.1540 and 107.1550; minus

(2) All previous Distributions under this section and § 107.1570(a) that were applied as redemptions or repayments of Leverage; plus

(3) All previous Distributions under § 107.1570(b) that reduced your Retained Earnings Available for Distribution.

* * * * *

38. Section 107.1570 is amended by adding a sentence at the end of the introductory text and by revising the heading of paragraph (b)(1) and paragraphs (b)(1)(i) and (b)(1)(ii) to read as follows:

§ 107.1570 Distributions by Licensee—optional Distributions to private investors and SBA.

* * * You must notify SBA of any planned distribution under this section 10 business days before the distribution date, unless SBA permits otherwise.

* * * * *

(b) *Other optional Distributions.*

* * *

(1) *Conditions for making a Distribution.* * * *

(i) You have distributed all Earned Prioritized Payments, earned Adjustments, and earned Charges, so that the balance in your Distribution Account is zero (see § 107.1520).

(ii) You have distributed all Profit Participation computed under § 107.1530 which you are required to distribute under § 107.1560 or permitted to distribute under paragraph (a) of this section, as appropriate, and you have made all required Distributions under § 107.1560.

* * * * *

39. Section 107.1575 is added to subpart I to read as follows:

§ 107.1575 Distributions on other than Payment Dates.

(a) *Permitted Distributions on other than Payment Dates.* Notwithstanding any provisions to the contrary in §§ 107.1540 through 107.1570, you may make Distributions on dates other than Payment Dates as follows:

(1) Required annual Distributions under §§ 107.1540(a)(1), and any Distributions under §§ 107.1550 and 107.1560, must be made no later than the second Payment Date following the end of your fiscal year;

(2) Required Distributions under § 107.1540(b) must be made no later than the first Payment Date following the end of the applicable fiscal quarter;

(3) Optional Distributions under § 107.1540(a)(2) and § 107.1570 may be made on any date.

(b) *Conditions for making Distribution.* All Distributions under this section are subject to the following conditions:

(1) You must obtain SBA's written approval before the distribution date;

(2) You must use the distribution date as the ending date of the period for which you compute your Earmarked Profits, Prioritized Payments, Adjustments, Charges, Profit Participation, Retained Earnings Available for Distribution, liquidity ratio, Capital Impairment, and any other applicable computations required under §§ 107.1500 through 107.1570;

(3) If your Distribution includes an amount which SBA will apply as a redemption of Participating Securities, the effective date of such redemption, for all purposes including future computations of Prioritized Payments, will be the next Payment Date following the distribution date.

40. In § 107.1580, the heading and introductory text of paragraph (a) are revised to read as follows:

§ 107.1580 Special rules for In-Kind Distributions by Licensees.

(a) *In-Kind Distributions.* A Distribution under §§ 107.1540, 107.1560 or 107.1570 may consist of securities (an ''In-Kind Distribution'').

Such a Distribution must satisfy the conditions in this paragraph (a).

* * * * *

41. Section 107.1590 is amended by removing paragraph (c), redesignating paragraph (d) as paragraph (c), and revising paragraph (a)(1) to read as follows:

§ 107.1590 Special rules for companies licensed on or before March 31, 1993.

* * * * *

(a) *Election to exclude pre-existing portfolio.* * * *

(1) The proceeds of your first issuance of Participating Securities are not used to refinance outstanding Debentures (see § 107.1585(a)). SBA will consider payment or prepayment of any outstanding Debenture to be a refinancing unless you demonstrate to SBA's satisfaction that you can pay the Debenture principal without relying on the proceeds of the Participating Securities.

* * * * *

42. In § 107.1600, the first sentence of paragraph (a) and paragraph (b) are revised to read as follows:

§ 107.1600 SBA authority to issue and guarantee Trust Certificates.

(a) *Authorization.* Sections 319(a) and (b) of the Act authorize SBA or its CRA to issue TCs, and SBA to guarantee the timely payment of the principal and interest thereon. * * *

(b) *Periodic exercise of authority.* SBA will issue guarantees of Debentures and Participating Securities under section 303 and of TCs under section 319 of the Act at six month intervals, or at shorter intervals, taking into account the amount and number of such guarantees or TCs.

* * * * *

43. Section 107.1720 is added to subpart I to read as follows:

§ 107.1720 Characteristics of SBA's guarantee.

If SBA agrees to guarantee a Licensee's Debentures or Participating Securities, such guarantee will be unconditional, irrespective of the validity, regularity or enforceability of the Debentures or Participating Securities or any other circumstances which might constitute a legal or equitable discharge or defense of a guarantor. Pursuant to its guarantee, SBA will make timely payments of principal and interest on the Debentures or the Redemption Price of and Prioritized Payments on the Participating Securities.

44. In § 107.1820, paragraph (e)(9) is revised to read as follows:

§ 107.1820 Conditions affecting issuers of Preferred Securities and/or Participating Securities.

* * * * *

(e) *Restricted Operations Conditions.*

* * *

(9) *Failure to meet investment requirements.* You fail to make the amount of Equity Capital Investments required for Participating Securities (§ 107.1500(b)(4)), if applicable to you; or you fail to maintain as of the end of each fiscal year the investment ratios or amounts required for Leverage in excess of 300 percent of Leverageable Capital (§ 107.1160(c)) or Preferred Securities in excess of 100 percent of Leverageable Capital (§ 107.1160(d)), if applicable to you. In determining whether you have met the maintenance requirements in § 107.1160(c) or (d), SBA will disregard any prepayment, sale, or disposition of Venture Capital Financings, any increase in Leverageable Capital, and any receipt of additional Leverage, within 120 days prior to the end of your fiscal year.

* * * * *

45. In § 107.1830, paragraph (a) is revised to read as follows:

§ 107.1830 Licensee's Capital Impairment—definition and general requirements.

(a) *Applicability of this section.* This section applies to Leverage issued on or after April 25, 1994. For Leverage issued before April 25, 1994, you must comply with paragraphs (e) and (f) of this section and the Capital Impairment regulations in this part in effect when you issued your Leverage. For all Leverage issued, you must also comply with any contractual provisions to which you have agreed.

* * * * *

Dated: January 28, 1998.

Aida Alvarez,

Administrator.

[FR Doc. 98–2556 Filed 2–4–98; 8:45 am]

BILLING CODE 8025–01–P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 39

[Docket No. 97–NM–261–AD; Amendment 39–10300; AD 98–03–08]

RIN 2120–AA64

Airworthiness Directives; Fokker Model F27 Mark 050 Series Airplanes

AGENCY: Federal Aviation Administration, DOT.

ACTION: Final rule; request for comments.

SUMMARY: This amendment adopts a new airworthiness directive (AD), applicable to certain Fokker Model F27 Mark 050 series airplanes. This action requires modification of the window frames surrounding the windshield windows and installation of reinforcement plates on all window frames of the flight compartment. For certain airplanes, this action requires modification of the window frames surrounding the sliding windows and direct vision windows of the flight compartment. This amendment is prompted by the issuance of mandatory continuing airworthiness information by a foreign civil airworthiness authority. The actions specified in this AD are intended to prevent structural degradation of the window frames of the flight compartment, which could result in depressurization of the airplane during flight.

DATES: Effective February 20, 1998.

The incorporation by reference of certain publications listed in the regulations is approved by the Director of the Federal Register as of February 20, 1998.

Comments for inclusion in the Rules Docket must be received on or before March 9, 1998.

ADDRESSES: Submit comments in triplicate to the Federal Aviation Administration (FAA), Transport Airplane Directorate, ANM–114, Attention: Rules Docket No. 97–NM–261–AD, 1601 Lind Avenue, SW., Renton, Washington 98055–4056.

The service information referenced in this AD may be obtained from Fokker Services B.V., Technical Support Department, P.O. Box 75047, 1117 ZN Schiphol Airport, the Netherlands. This information may be examined at the FAA, Transport Airplane Directorate, 1601 Lind Avenue, SW., Renton, Washington; or at the Office of the Federal Register, 800 North Capitol Street, NW., suite 700, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Norman B. Martenson, Manager, International Branch, ANM–116, FAA, Transport Airplane Directorate, 1601 Lind Avenue, SW., Renton, Washington 98055–4056; telephone (425) 227–2110; fax (425) 227–1149.

SUPPLEMENTARY INFORMATION: The Rijksluchtvaartdienst (RLD), which is the airworthiness authority for the Netherlands, notified the FAA that an unsafe condition may exist on certain Fokker Model F27 Mark 050 series airplanes. The RLD advises that it has received a report indicating that, during